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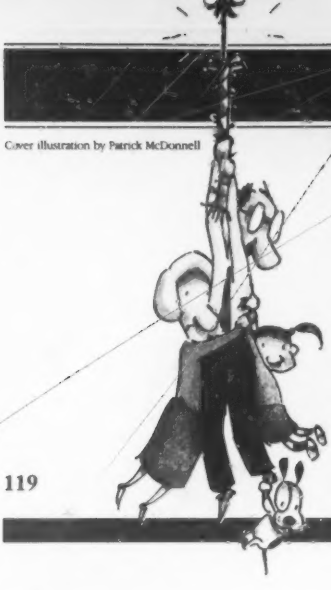

119

57 *Brooklyn Union's Elwin Larson*

MARCH 20, 1989
VOLUME 143
NUMBER 6

THE EDITORIAL INDEX OF COMPANIES REFERRED TO IN THIS ISSUE IS ON PAGES 6 AND 7.

COVER STORY

119 House-hunting? Read This First
By Laura Saunders
Home buyers assume there will always be a home mortgage interest deduction. That could be a big mistake.

COMPANIES

57 Brooklyn Union Gas
By James Cook
Selling natural gas like toothpaste.

68 The Up & Comers: Osborn Communications
By Ronald Bailey
Frank Osborn's thriving little media company.

72 The Up & Comers: Sock Shop International
By Diana Fong
It started with one simple run in Sophie Mirman's stocking.

80 The Up & Comers: Benihana
By Eric Schmuckler
Can Rocky Aoki learn the virtues of restraint?

86 Hibernia Corp.
By John H. Taylor
Making money in one of the worst banking markets in America.

88 Daimler-Benz
By Peter Fuhrman
A call to arms: Edzard Reuter pushes mighty Daimler-Benz into aerospace.

107 Melvin Simon Associates
By Steve Weiner
Mel and Herb Simon plastered the Midwest with look-alike regional malls. Now they've grown up and so have their risks.

127 Unum Corp.
By Laura Jereski
An insurance company that's not singing the blues.

134 Cathay Pacific
By Andrew Tanzer
An airline that frets that its load factor is too high.

171 Johnson Controls
By Alyssa A. Lappen
What's it doing in the car battery, car seat and plastics businesses?

174 Dresser Industries
By Toni Mack
How Jack Murphy turned losses into profits in five years.

ECONOMICS

39 Moscow's Hard Choices
By Laurence Minard
Gorbachev's nearly impossible battle to correct his country's budget deficit.

40 Keeping The Cow, Selling The Milk
By Howard Banks
Contrast Air Products' ten-year plan with Fed Chairman Greenspan's anxiety about tight industrial capacity.

PROFILES

96 Dickson Poon
By Andrew Tanzer
His goal: a net worth of $1
30. He missed it by only a

NUMBERS GAME

48 A Colossal Case Of Apples And Orange
By Penelope Wang
Finally, banks are dis
lending to highly lever
tions. Too bad that's me

INVESTING

62 The Money Men: Value Is Where You
By Jonathan Clements
Some days, Fireman's F
stock picker, Bob Bruce,
ther than his office wall

208 The Funds: Better Dead Than A
By Jonathan Clements
Peter Cundill searches
companies trading at l
working capital.

210 Statistical Spotligh Born-Again Stocks
By Christopher Palmeri
Looking for potential w
former leveraged buyou

220 Streetwalker
Jiffy Lube Internationa
Phillips-Van Heusen; H

IDEAS

43 Meet The Meatless
By Richard Behar
How a handful of True
nipulate the media and
tries to tremble.

88 *The Airbus assembly line Daimler-Benz wants to acquire*

184 *Try an accountant*

122 **As I See It: "The Japanese Are Not Superhuman"**
By George Gilder
A chat with Bell Labs' Arno Penzias.

ON THE DOCKET

100 **Palm Springs Ploy**
By Peter Newcomb
Can a hotel turn itself into a video rental store and beat Hollywood out of movie royalties? Apparently so.

REGIONS

105 **Report From The People's Republic Of Santa Monica**
By Marc Beauchamp
Ten years into some of the toughest residential rent control in the U.S.

INDUSTRIES

38 **Detroit's Euro-Boom**
By John Marcom Jr.
In the Old World's mature but affluent markets, Ford and GM are raking it in.

42 **Bunnyburgers**
By Jacon Zweig
Is rabbit about to replace hamburger and chicken wings in U.S. kitchens?

130 **Fishy Arguments**
By Marc Beauchamp
With prices rising, Seattle fishermen were all for free markets. No more.

SCIENCE & TECHNOLOGY

178 **Clinical Case**
By Ignatius Chithelen
In a high-tech service business, the service may count more than the technology. Just ask MetPath.

COMPUTERS/COMMUNICATIONS

184 **Should You Do Your Taxes On Your PC?**
By David Churbuck
Which is a better investment, $89 for a personal computer tax program or $500 for an accountant to do your taxes? For most people, the latter.

186 **Utility Infielder**
By David Churbuck
Mainframes may be headed for extinction, but that day is a long way off. So VM Software is doing just fine.

MARKETING

188 **The Price Of "Cheap Eyeballs"**
By Fleming Meeks
National advertisers are squeamish about them, but the number of trash TV shows is rising fast. Something's got to give. Also: Tony Lama is back.

PERSONAL AFFAIRS

192 **Muscle Fever**
By Neal Santelmann
Baby boomers drive up prices for the dream cars of their youth. Also: Arbitrating disputes on Wall Street, collecting prints.

CAREERS

198 **Pepperidge Farm's Doughboy**
By Dyan MacCann
It is one smart company because of people like Herb Tolmich, the Thomas Edison of cookies.

DEPARTMENTS

8 Side Lines
10 Follow-Through
14 The Informer
16 Readers Say
19 Fact and Comment
24 Other Comments
27 Fact and Comment II
31 Commentary
223 Flashbacks
224 Thoughts

COLUMNISTS

54 Michael Novak
213 Ben Weberman
214 David Dreman
215 Ann C. Brown
216 Ashby Bladen
217 Mark Hulbert

MONEY & INVESTMENTS

33 What's Ahead For Business
34 The Forbes Index
203 The Forbes/Wilshire 5000 Review

FACES BEHIND THE FIGURES

200 **Zeger van Asch van Wijck**
Port of Seattle
200 **Robert Bernstein and James Meehan**
Delaware Management Co.
201 **George Simpson**
Rover Group
201 **Daniel Krumm**
Maytag Corp.

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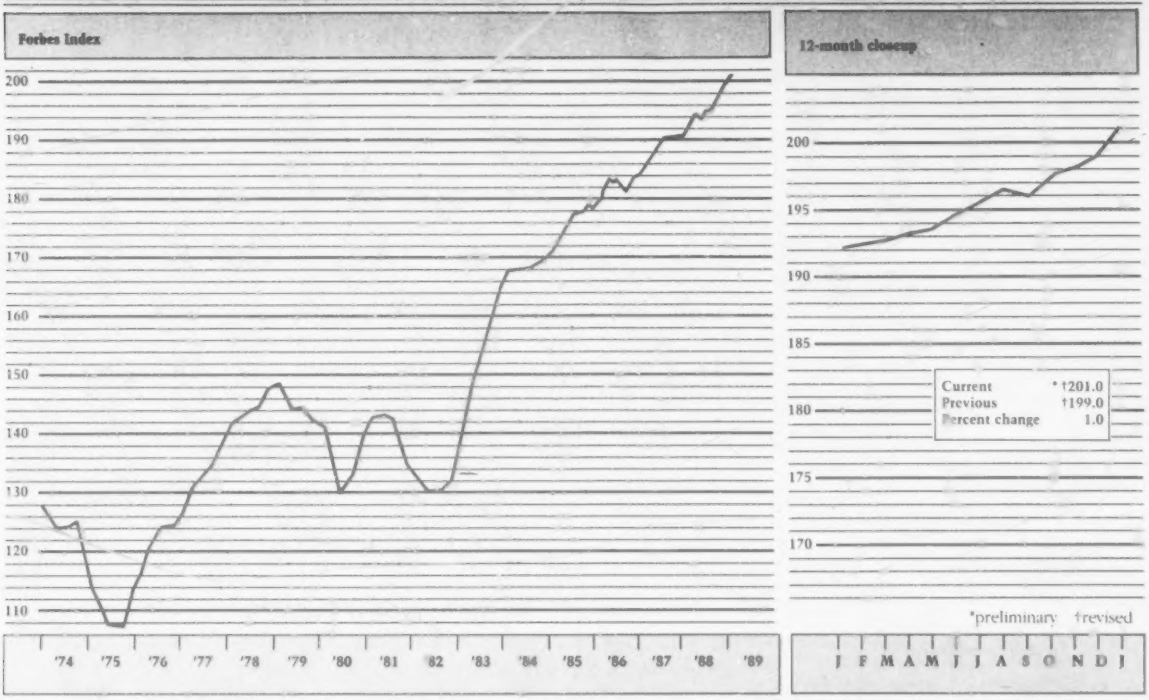
The Forbes Index

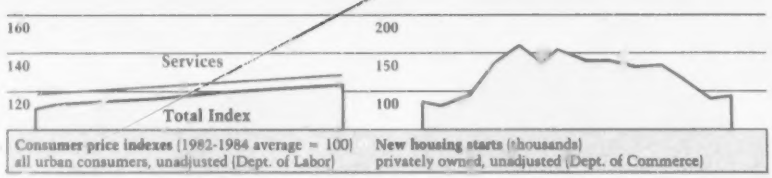


The economy is expanding rapidly, perhaps too rapidly. The Consumer Price Index jumped 0.5% in January before seasonal adjustment, the biggest rise since August. It was caused by significant increases in the cost of building materials, general merchandise, food and medicine. The index' services component rose 0.6%. In response to these inflationary signs, the Federal Reserve raised the discount rate (the loan rate it charges member banks) to 7%. Retail sales were up 0.6% in January, with virtually all of the rise attributed to higher prices rather than higher unit sales. A cold January did not prevent new housing starts from registering a 27.5% increase over January 1988.

The Forbes Index Components

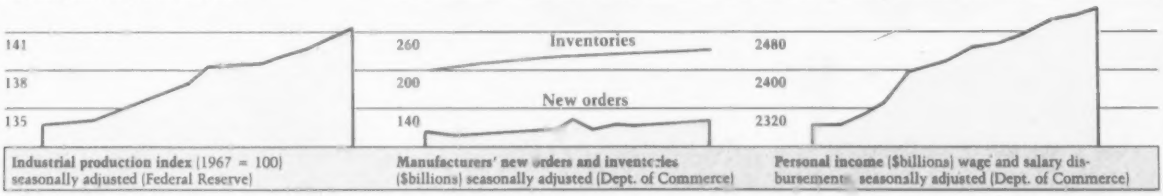
The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, Forbes monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.



Consumer price indexes (1982-1984 average = 100) all urban consumers, unadjusted (Dept. of Labor)

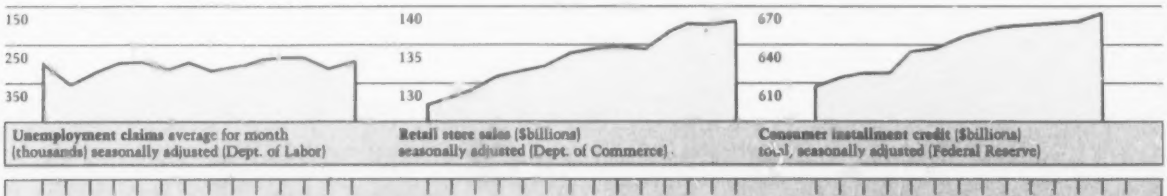
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)



Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)

Manufacturers' new orders and inventories ($billions) seasonally adjusted (Dept. of Commerce)

Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)



Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)

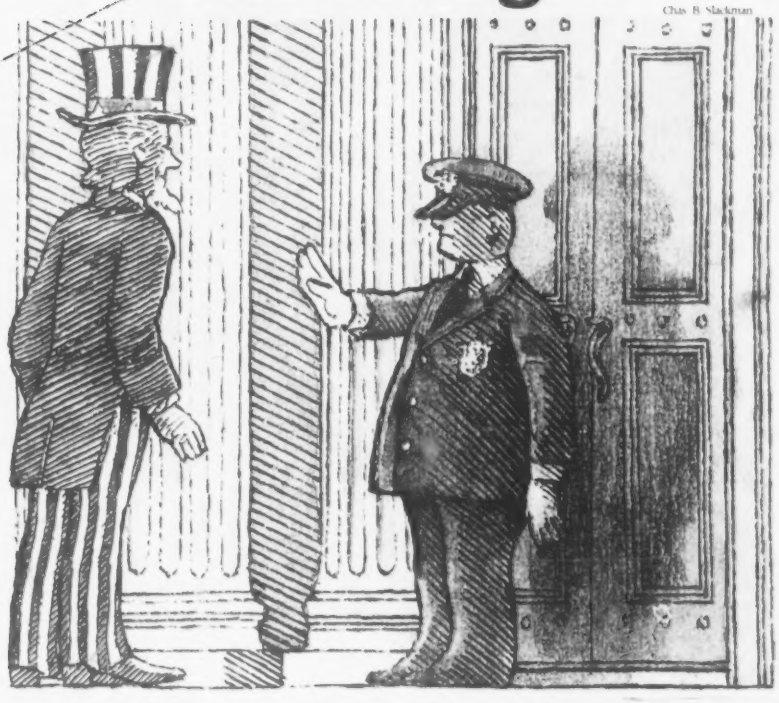
Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)

Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

Numbers Game

Finally, banks are disclosing their lending to highly leveraged transactions. Too bad the disclosures are virtually meaningless.

A colossal case of apples and oranges



By Penelope Wang

AFTER YEARS OF SECRECY, repeated demands by financial analysts and increasing regulatory pressure, banks are finally disclosing information about their lending to highly leveraged transactions such as leveraged buyouts. Is that good news? Not quite. What is emerging is a colossal case of apples-and-oranges accounting.

In December, for example, Bankers Trust reported that its leveraged lending portfolio stood at $3.3 billion, or about 13% of total loans. What constitutes leveraged lending to this bank? Any transaction in which debt equals 70% or more of total capital.

Now consider Chemical Bank. At year-end it reported that loans outstanding to leveraged corporate transactions total $2 billion, or 4.8% of its total loan portfolio. What definition of "leveraged" did the bank use to arrive at this figure? All transactions in which the borrower's indebtedness exceeded its tangible net worth by more than 3-to-1. To add to the confusion, unlike Bankers Trust, Chemical's figure included total lending outstanding, not just senior debt.

In sum, anyone who thinks Bankers Trust is twice as risky an investment as Chemical because it has more than twice as much of its portfolio in leveraged transactions is guilty of mixing apples and oranges. "We are at the point where no two banks' leveraged buyout disclosures are alike," complains George Salem, banking analyst at Prudential-Bache.

At the root of the problem are government regulators, who are responding to congressional anxiety over leveraged buyouts and junk bond financing. Heavy lending to those markets spurred the Comptroller of the Currency and the Securities & Exchange Commission to push the

Dare to compare

Consider these reports from five major money center banks of loans made for highly leveraged transactions. Now consider their definitions. Can anyone sensibly compare one bank with another on such bases?

Bank	Leveraged loans outstanding* ($bil)	% of total loans	Definition of leverage
Bank of America	$1.3	2.0%	LBO and recapitalizations outstanding, including various forms of acquisition and other leveraged financing.
Bankers Trust	3.3†	13.0†	Acquisitions in which debt to total capitalization is 70% or greater.
Chemical Bank	2.0	4.8	Borrowers' indebtedness exceeds tangible net worth by more than 3-to-1.
Chase Manhattan	1.3	1.9	Transactions that result in a change in ownership and in a company's capital structure, maximizing leverage.
Citicorp	4.2 (U.S.only)	2.8	Senior lending for the acquisition of commercial and industrial companies.

*1988 year-end figures. †As of Dec. 7, 1988.

Source: company data.

banks for greater review and disclosure of what is actually in their loan portfolios. Yet the regulators have not provided anyone, least of all the banks, with a definition of what constitutes a leveraged transaction in the first place. "If it looks leveraged, it probably is leveraged," sighs one SEC staffer, "but most of us would be hard-pressed to come up with a definition."

But just such a definition is indispensable, of course, if bank reporting is to have any meaning at all. Just when does a deal become so highly

Complains banking analyst George Salem of Prudential-Bache, "We are at the point where no two banks' leveraged buyout disclosures are alike."

leveraged, and therefore risky, that it must be disclosed? At a 3-to-1 debt-to-equity ratio? At 10-to-1?

What's more, leverage per se does not automatically equal risk. Notes Stephen Skaggs, vice president at Alex Sheshunoff & Co., the Texas-based bank analysis group, "The real factor in these transactions isn't so much the leverage as the cash flow." Skaggs points out that a buyout leveraged at 5-to-1 might not have cash flow to cover interest payments, whereas a deal at 10-to-1 might well have more than enough cash flow to cover interest costs.

Another problem is that highly leveraged deals may include a smorgasbord of transactions, from LBOs to mergers to ESOPs, each one subject to different types of risk. The definition could even include funding for venture capital and research and development deals.

What to do about this accounting mess? Recently a glimmer of hope appeared on the horizon, when the Federal Reserve directed bank managers and examiners to review leveraged transactions that exceed a debt-to-equity ratio of 3-to-1. That's an arbitrary level, to be sure, but an arbitrary definition is better than no definition if everyone agrees to accept and use it. That way, at least it is possible to have comparability.

Unfortunately, the SEC, which regulates reporting to the public, has no plans to require banks to use the Fed's guidelines in their loan disclosures. Meanwhile, 1988's crop of annual reports is already at the printers or even in the mail, chock-full of apples and oranges to frustrate and confuse any investor trying to figure out which banks are the safest banks. ■

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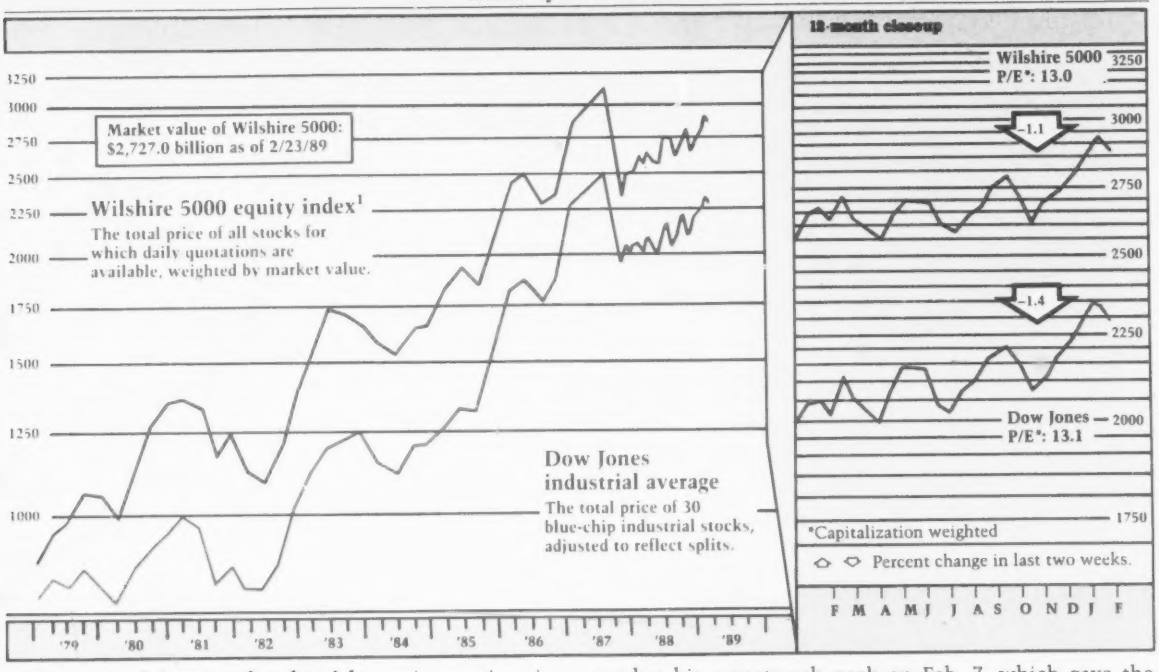
The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



Investment advisers are less bearish—an interesting sign for contrarians because these experts are often wrong. Michael Burke, editor of *Investors Intelligence*, a New Rochelle, N.Y.-based newsletter that tracks 135 investment advisers, reports that currently 34.2% of them are bearish. According to Burke, this is the lowest level of pessimism since the crash.

In December the bearish camp comprised over 55% of Burke's survey group. What happened since then? The market hit a postcrash peak on Feb. 7, which gave the Wilshire index a gain of 7.6% since the start of the year. Now Burke, who puts great faith in his indicator, thinks that stock prices are due for a correction.

Share prices, indeed, lost ground during the last two weeks. In addition to Burke's sentiment indicator, investors also had to worry about rising interest rates. The Dow and S&P 500 declined by 1.4%, while the Amex and Nasdaq stocks lost about half as much.

Closeup On the Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[2]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	0.7	0.1	–0.1	0.3	0.6	1.5
in last 52 weeks	11.7	11.5	13.5	11.4	14.1	10.8

Stock performance based on six key investor yardsticks[3]

Percent change	Company size		Volatility[4]		P/E multiple		Dividend yield		Growth profile[5]		Share price	
	large	small	high	low	over 21	under 8	over 4.5%	none	high	low	over $34	under $4
in last 4 weeks	0.9	2.5	2.2	–0.2	1.8	2.8	0.4	0.7	2.8	0.6	1.3	2.7
in last 52 weeks	13.6	13.6	12.9	5.2	26.7	13.4	1.2	17.3	12.3	10.9	19.0	0.4

[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. [2]Based on sales. [3]Equal weighted indices containing all shares with market capitalizations over $10 million. [4]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable. [5]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

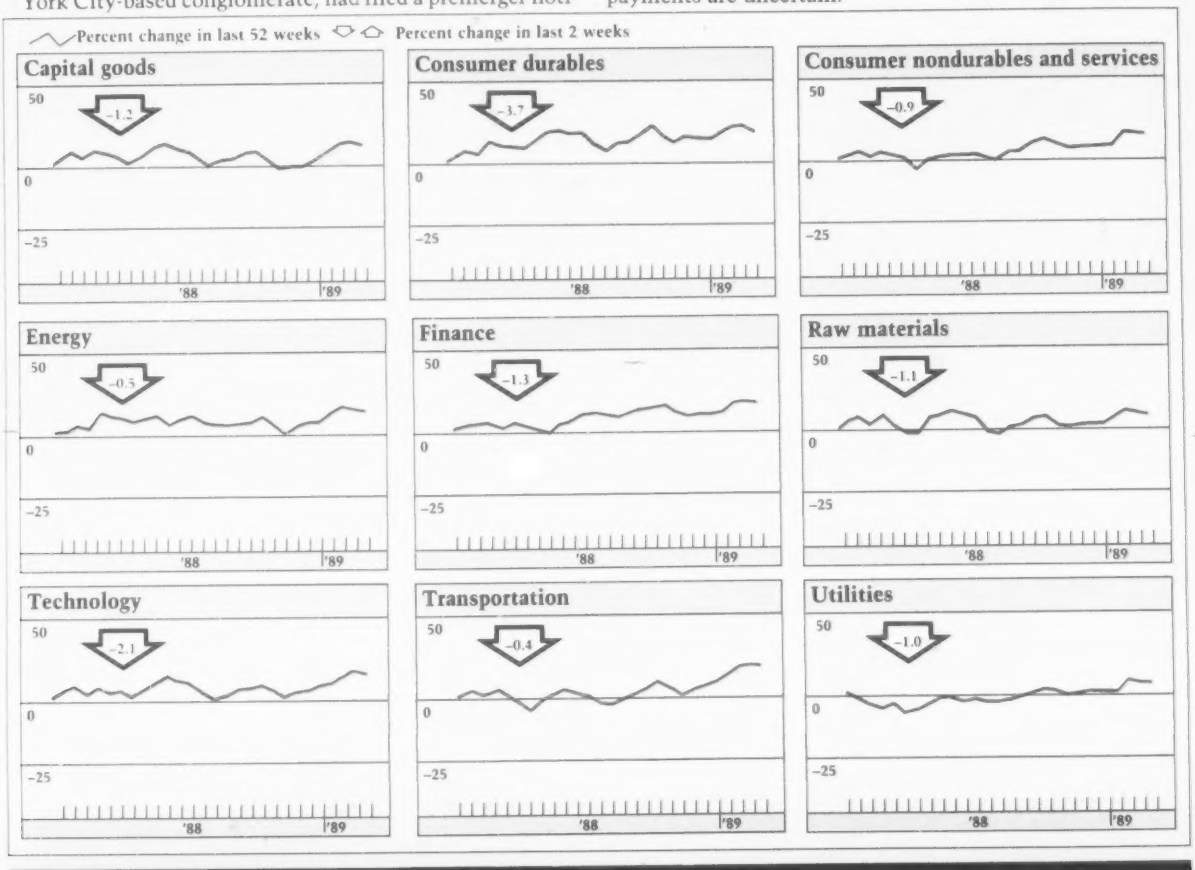
Note: All data for periods ending 2/23/89. Prepared by Wilshire Associates, Santa Monica, Calif.

Steven Ramos

Where the Action Is

There's nothing like a takeover threat to move a stock. Although the capital goods sector declined 1.2% during the last two weeks, one stock in the group, Precision Castparts, rose 28%, to 36½. The Portland, Ore.-based manufacturer of castings for the aerospace industry announced on Feb. 15 that Sequa Corp., a $1.7 billion New York City-based conglomerate, had filed a premerger notification form with the Federal Trade Commission stating its intention to acquire up to 24.99% of Precision.

Despite the drop in the overall averages, Tambrands, Aristech Chemical and Emhart all posted gains of 15% or more. But El Paso Electric declined 18.3% on news that its chief executive had resigned and that future dividend payments are uncertain.



What the Analysts Think

Flying against a headwind. The transportation sector as a whole had some of the biggest cuts in earnings estimates during the last four weeks, but several airline stocks were treated to increases in their 1989 earnings forecasts. Analysts raised their estimates for UAL, Alaska Air and AMR by 4% or more during the past four weeks.

Forecasting the Forbes Sales 500

Performance period	Average earnings per share	P/E
latest 12 months	$3.36	12.0
1989 estimates	3.96	10.2
1990 estimates	4.37	9.4

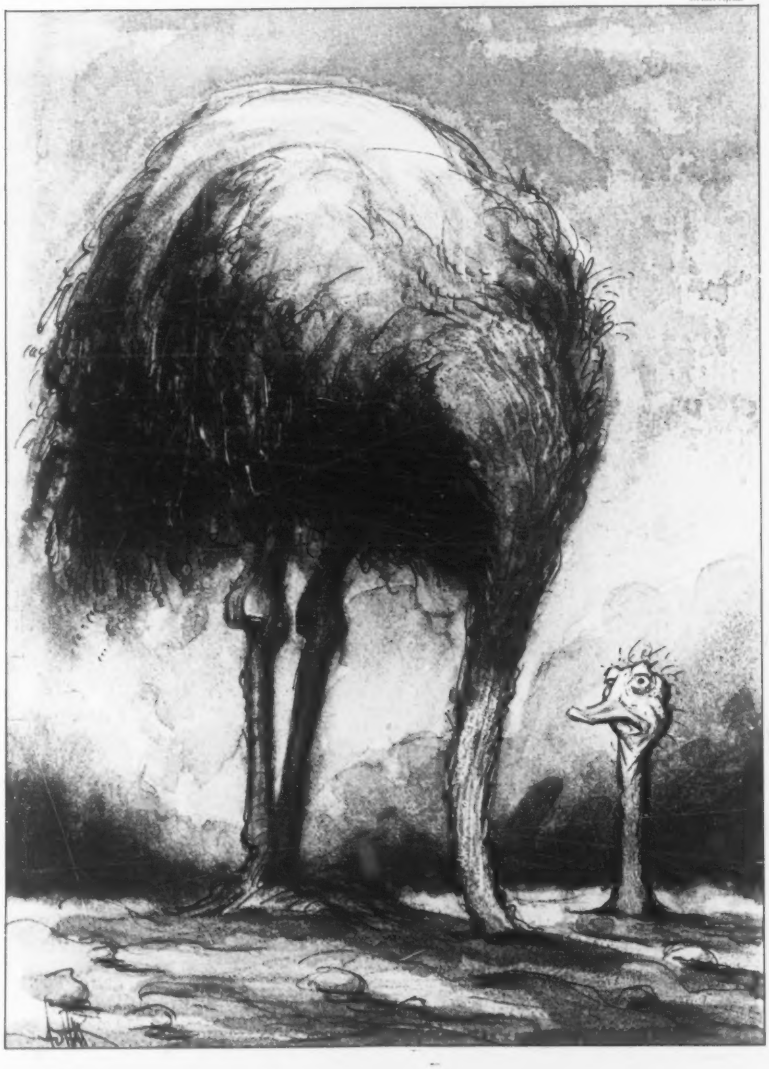
Rank based on change in estimate	Sector	Estimated 1989 EPS	Estimated 1989 P/E	% change in 1989 estimate in 2 weeks	% change in 1989 estimate in 4 weeks
1	Raw materials	$3.54	9.2	0.49%	1.49%
2	Consumer durables	5.05	10.7	0.21	1.99
3	Finance	3.76	7.9	0.16	0.14
4	Energy	3.06	12.0	0.07	0.41
5	Consumer nondurables	2.73	12.9	–0.06	–0.04
6	Utilities	3.08	10.1	–0.15	–0.08
7	Capital goods	3.03	12.8	–0.21	–0.88
8	Transportation	2.83	10.5	–0.23	–0.74
9	Technology	3.22	11.0	–0.48	–0.68

Earnings projections are capitalization-weighted consensus estimates from over 3,000 security analysts. Data are compiled and updated continually by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 2/23/89. Prepared by Wilshire Associates, Santa Monica, Calif.; IBES, a service of Lynch, Jones & Ryan, New York.

No surprise: Companies that went private a few years back are going public again. Here, tips on spotting potential winners.

Born-again stocks



Brian Ajhar

By Christopher Palmeri

COMPANIES THAT WERE acquired via leveraged buyouts are now seeing the light of public ownership again. That's because converting LBO debt into public equity is just one more opportunity for investment bankers, private investors and management to make money on the deal. But the dealmakers have been leaving a little money on the table for individual investors, too.

We studied 70 former leveraged buyout firms that made $20 million-plus new public offerings in the period from 1980 to May 1988. From their initial offering price to the present, these 70 stocks have an average relative performance of 113. For reference, a stock that posted the same gain as the S&P 500 would have a relative performance of 100.* In short, the recycled LBOs did significantly better than the market. The 70 stocks also turned in a respectable 17% average annual return.

Which stocks did the best? The winners' list is peppered with brand names like Harley-Davidson, A&W Root Beer, Budget Rent a Car, Formica, Tiffany and Topps bubblegum cards. Brand names have had a good run recently on Wall Street—think of the recent takeovers of packaged goods companies—and that applies whether they belong to firms that have been public for decades or to companies that were recently listed.

Takeovers increased the value of several of the best-performing LBOs-gone-public. Four of the top 15 issues were reacquired, and 2 more, Formica and Budget Rent a Car, appear to be headed in the same direction. As a whole, 19% of the 70 stocks in our study were reacquired, a percentage roughly double that of all initial public offerings over the same period.

We also found that LBOs done by merchant banking firms or outside investors generally did better after going public than did purely management-led buyouts. One conspicuous exception to this rule is Kohlberg Kravis Roberts, the buyout pioneer that juggled the $25 billion purchase of RJR Nabisco. In the ten deals we monitored, KKR had an average relative performance of only 88. Child World and

More precisely: Take the sum that a $100 investment in the stock would have grown to. Divide it by the amount that $1 invested in the S&P would have grown to over the same period, not counting dividends. The resulting quotient is the relative performance.

L.B. Foster, on the other hand, were the firm's biggest losers.

What fundamentals are associated with good performance of an LBO going public? "Ignore price/earnings and price/book ratios," says McKinley Allsopp analyst Richard Haydon. "The most important thing is the level and stability of operating income," by which he means earnings before taxes, interest and depreciation. And, he says, "You must go beyond what is in the prospectus and make estimates of that cash flow."

First Chicago Venture Capital President John Canning, who has put over $600 million of the bank's money into leveraged buyouts, says he considers most industrial companies a value at 7½ times operating income, although communications companies often command multiples of 10 to 15. Canning includes debt assumed in the price of a company.

Take Outlet Communications, a Providence-based radio and TV station operator that William Simon's Wesray Capital bought from the Rockefeller Group in 1986. Outlet went public in January 1987 at 11¼ and now trades at 26, even though it has a negative book value and no earnings.

What makes Outlet valuable? The real cost of acquiring any firm is the sum of its market price and its total debt. Currently at 26, and with $27 a share in long-term debt, Outlet has an acquisition cost of about $53 a share. What you get is a property with 1988 operating income of $4.88 a share. The market, then, is pricing Outlet at 11 times operating income. ■

Gone today, here tomorrow

Companies that have gone private in leveraged buyouts are popping back up on Wall Street's ticker machines. In the past eight years more than 70 former LBOs have been taken public with stock offerings valued at $20 million or more. The best and the worst of the lot are listed below. Companies with strong, identifiable brand names seem to have the best chance of performing well after going public.

Company/industry	Pre-LBO owner	Buyout group	Offer date	Offer price	Recent price	% change	Relative to S&P
Winners							
Georgia Gulf/chemicals	Georgia-Pacific	management	Dec 86	9¾	42⅞	340	367
Specialty Equipment/food service equip*	Beatrice	Gibbons Green van Amerongen	July 87	12	33	175	318
Anitec Image Technology/photo process*	GAF	outside investors	May 85	7⅜	25½	248	290
Vista Chemical/chemicals	Conoco	Gordon Cain	Dec 86	17	56⅛	230	276
Topps/bubble gum cards	firm was public	Forstmann Little	May 87	13	36⅜	182	266
Outlet Comms/radio, TV stations	Rockefeller Group	Wesray Capital	Jan 87	11¼	26¼	133	211
Budget Rent a Car/car rental	Transamerica	Gibbons Green van Amerongen	May 87	14	29½	111	200
Wellman/polyester fiber	firm was private	management	June 87	20½	41⅜	102	199
Formica/laminates	Amer Cyanamid	management	June 87	11¾	22¼	89	196
Harley-Davidson/motorcycles	AMF	management	July 86	11	26⅜	140	195
Tiffany/retailing	Avon Products	management	May 87	23	44⅛	92	191
A&W Brands/soft drinks	United Brands	Alfred Taubman	May 87	11	18	64	162
Western Auto Supply/auto parts*	Beneficial Corp	Wesray Capital	Jan 87	13	19	46	151
Foodmaker/fast-food stores*	Ralston Purina	Gibbons Green van Amerongen	Feb 87	13½	19⅜	44	147
Ladd Furniture/furniture	Sperry & Hutchsn	management	Aug 83	5⅜	14	160	141
Losers							
MAI Basic Four/computers	Mgmt Assistance	Bennett LeBow	June 86	15	10½	–30	58
Leslie Fay/women's apparel	firm was public	Odyssey Partners	Aug 86	18	12¼	–32	54
Child World/toy stores	Cole National	Kohlberg Kravis Roberts	Aug 85	16¾	13¾	–18	52
Allstar Inns/hotels	privately held	outside investors	Mar 87	12½	6¼	–50	52
Charter Power System/batteries	Allied Corp	management	Feb 87	11	5⅝	–49	48
Gtech/lottery systems	Datatrol	Bass Brothers Enterprises	July 83	13¼	10½	–21	45
Reliance Group/insurance	firm was public	Saul Steinberg	Sep 86	10	5¾	–43	45
Communications Trans/telephone lines	Times Mirror	management	Oct 87	12	4¾	–60	42
Pannill Knitting/sportswear	firm was private	management	June 86	21	9⅝	–54	37
Cato/retailing	firm was public	management	Apr 87	12	4⅜	–64	35
Lincoln Foodservice/food service	Alcoa	Wesray Capital	June 86	15½	6⅜	–59	33
Chartwell Group/lamps	firm was private	management	Mar 86	14	4½	–68	25
Healthcare Int/psychiatric hosp	firm was private	management	Oct 85	9½	3	–68	20
LB Foster/pipes, tubing	firm was public	Kohlberg Kravis Roberts	June 81	17	5⅝	–67	15
Ramsay HealthCare/psychiatric hosp	Amer Medical Intl	management	Aug 85	12	2⅛	–82	11

*Firm was reacquired.

Sources: Securities Data Corp.; FORBES.